BRIEF IN SUPPORT OF PETITION

The petition should be granted because, although this cause requires the construction of sections 217, 213(a), and 214(a) of the Revenue Act of 1926, together with Treasury Regulations 69, Article 328, promulgated under said Revenue Act, the decision below fails to construe said statutes and regulation. Their proper construction is a question of substance because these statutes are a fundamental part of the federal revenue laws and their construction with reference to non-resident aliens who have failed to file income tax returns remains unsettled by this Court and even by lower courts. It is further submitted that this petition should be granted because, with respect to other questions involved, the decision below is probably in conflict with the applicable decisions of this Court.

I.

The question of construction above stated is as follows: Where a non-resident alien sells within the United States property which he has created in a foreign country and without fraudulent intent to evade income taxes, fails to file federal income tax returns, does section 217(g)(1) permit the Commissioner, in making a return for the non-resident alien, to treat the entire proceeds of sale of the property in the United States as gross income, denying to the alien the right to have gross income computed by subtracting from gross sales the actual cost of producing the property?

The Court below, in its opinion, did not question the fact that the moneys deposited by Horch in the New York bank account, which the respondent claims were the proceeds of sales of paintings, were entirely consumed for the

purpose of the expedition to Asia. Thus it said (Appendix p. ~~35~~ 37):

> "It appears that Roerich used the disputed sums to defray expedition expenses * * *."

Assuming that the paintings were in fact sold to the Roerich Museum or to Horch, it is the petitioner's contention that the expedition expenses constituted the actual cost of production of the paintings. As the purpose of the expedition was to make these paintings, the expedition expenses were not of a collateral character such as traveling expenses and other "ordinary and necessary expenses" allowed as deductions from gross income by section 214(a). Due to the unusual facts of this case the cost of production happened to be traveling and other expenses of an expedition in Central Asia. It is apparent from Treasury Regulations 69, Article 328, Case 2A, that the "expenses, losses or other deductions", with the allocation of which that Article is concerned, are part of gross income and not of gross sales. The distinction between gross income and gross sales is there clearly recognized. It is submitted that to construe section 217(g)(1), which denies to non-resident aliens "the benefit of the deductions and credits allowed in this title" where no return has been filed, and section 214(a) which is referred to in section 217(g)(1) so as to penalize a non-resident alien to the extent of taxing him upon gross sales instead of gross income would be unjust and clearly erroneous. We have not been able to find any decision or authority supporting such a construction.

The Board of Tax Appeals held (R. ~~65~~ 56) that the petitioner was taxable on the expedition expenses because, under section 217(g)(1) he was denied the right to make any deductions. The Board treated the bank deposits in

question as gross income. The Court below refused to consider this question (Appendix p. 35) because it took the view that this question was not raised before the Board. It is respectfully submitted that the Court was in error. The petition to the Board (R. 10, 11) assigned as error the fact that the bank deposits claimed by the Commissioner to be the proceeds of sales of paintings in 1926 and 1927 were "entirely spent for the expenses of the expedition", and it was alleged in the petition that therefore these moneys were not income. If the expedition expenses were claimed as deductions, under section 214(a), disallowance of them would have been correct. However, the Board had before it the question of taxable income, of gross income. The Board erroneously affirmed the tax upon the expedition expenses, regardless of the established fact that the bank deposits were used for such expenses. This, it is submitted, was an erroneous construction of section 213(a), defining gross income as "gains, profits and income * * *." It is further submitted that the Court below had the same question before it. If the Court below had any doubt, which does not appear to be the case, that the bank deposits were entirely used for expedition expenses it should have remanded the cause for further hearing at which the petitioner would have the opportunity to prove that the bank deposits were entirely used for expedition expenses.

It is true that at the hearing the proof offered on behalf of the petitioner was almost entirely devoted to the question as to whether these paintings were sold at all. The petitioner's contention has been, and still is, that there was no sale; but that on the contrary he was employed, without compensation, by the Roerich Museum, or by Horch, to go to Asia to make a special series of paintings. Having found against him on the issue as to the sale of the paintings it

was, it is submitted, improper for the Board and for the Court below to disregard the issue as to what taxable income resulted from the sales. The plain facts of the case show that a great injustice has been done in that the petitioner has been burdened with a large income tax and penalties because of moneys which concededly constituted no profit to him.

II.

The Board's decision with respect to the effect of the transactions occurring in 1926 and 1927 is erroneous as a matter of law for the following reasons:

(a) The testimony of Horch that he purchased the paintings in 1926 and 1927 is a mere mistake of law and not evidence, (1) since it was a legal impossibility for Horch as Roerich's agent to sell Roerich's paintings to himself without communication with Roerich (*Wardell* v. *Railroad Co.* 103 U. S. 651, 658; *Neuendorff* v. *World Mutual Life Insurance Company,* 69 N. Y. 389, 392; *Restatement of Law of Agency,* Section 39; and (2) since Horch was not only disqualified as a matter of law from dealings on his own behalf with his principal, but the law made it impossible for him as an agent to modify the terms of the existing contract with the institutions in such a manner as to impose a heavy tax liability upon his principal without any advantage to the principal being possible or intended. While an agent may by error of judgment commit his principal to an unfavorable bargain, he is as a matter of law without power to act in such a manner as to result in known disadvantage to his principal. *Restatement of the Law of Agency,* Section 39, and Comment.

(b) The communications of Horch to Roerich during the years 1926 and 1927 did not purport to inform Roerich of any transaction directly between the two,

but reported merely the acquisition of the paintings by the museum for permanent exhibition. Ratification by the principal of the unauthorized acts of the agent cannot be based upon anything less than full disclosure by the agent of the nature of the unauthorized transaction.

III.

Petitioner's letter of August 29, 1928, did not constitute a ratification of the proposed sale.

(a) Because by the undisputed evidence the parties did not so intend it;

(b) Because no disclosure was made by the agent to the principal of the nature and consequences of the alleged transaction, particularly of the fact that the alleged modification of the agreement would involve the principal in heavy liability for income taxes without any compensating benefit whatever. It was the duty of the agent seeking ratification of an unauthorized transaction to make a full disclosure to his principal of such consequences. *Adair* v. *Brimmer,* 74 N. Y. 539, 554.

IV.

Even if the letter of August 29, 1928, was sufficient to raise a question of fact as to ratification of the unauthorized transaction the only income tax liability which could be affected was that for the year 1928 and not that for the years 1926 and 1927. The fiction that ratification relates back to the unauthorized transaction has no place in income tax law, since it would destroy the principle that income tax liability must be determined annually; transactions occurring after the close of the taxable year cannot alter the liability then determined. To permit taxpayers to hold transactions in suspense after the end of

the taxable year would result in great uncertainty in the administration of the law and would not in the long run be to the advantage of the Treasury. No deficiency assessment for the year 1928 can be made in this proceeding. *Blum* v. *Helvering,* 74 Fed. (2nd) 482, cert. denied, 295 U. S. 732.

V.

No income tax liability resulted from Roerich's performance of the agreement with the institutions since (a) the whole amount paid to him was disbursed for the expenses of the expedition and was never received for his own account; (b) even if all or part of amount were compensation for personal services, such services were rendered by a non-resident alien outside of the United States and were hence not subject to taxation in view of the provisions of Section 217(c)(3) of the Revenue Act of 1926. Moreover, since the appellate courts have no jurisdiction to make new findings of fact, liability, if any, must be based on a sale by Roerich to Horch.

VI.

Even if the transaction was a sale to Horch the proceeds were burdened with a trust for educational and artistic purposes and did not constitute income. *Decatur Water Supply Co.* v. *Commissioner,* 88 Fed. (2nd) 341.

VII.

The circumstances in connection with the failure to file the full return for 1934 have been set out in the statement of the case.

The Government had the burden of proof upon this issue. Section 907(a) of the Revenue Act of 1924, as

amended May 29, 1928, c. 852, § 601, 45 Stat. 872, provides:

> "In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, where no hearing has been held before the enactment of the Revenue Act of 1928, the burden of proof in respect of such issue shall be upon the Commissioner."

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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